knowledgeable thoughtful ethical experienced interactive

summaries

SIGMA INVESTMENT COUNSELORS

the official newsletter of sigma investment counselors August 2014

The Risk of Waiting for Interest Rates to Rise

It has been nearly six years since the Federal Reserve established a near-zero target range for the federal funds rate, or the interest rate at which depository institutions lend reserve balances to one another overnight. Further, almost five years have passed since the Fed implemented its first round of long-term bond purchases termed "quantitative easing", or QE. These policies have had the effect of keeping interest rates low in an attempt to increase the money supply and support higher levels of economic growth following the credit crisis of 2008-2009. Since these policies have been implemented, investors have been tasked with trying to assess when the Fed's actions will be reversed, which will most likely lead to higher interest rates.

Because current interest rates have been pushed to and held near all-time lows, many investors have been struggling to justify an allocation to high quality, investment grade bonds. Certain investors have shunned bonds altogether, choosing to "sit out" in cash-like investments until interest rates rise. When interest rates rise, bond prices fall. When bond prices fall, those who are on the sidelines can theoretically sidestep the price declines and are able to buy at lower prices and higher yields. It sounds like a reasonable plan, but how long are they willing to wait? I don't disagree that interest rates may be trending higher over the next several years. In fact, it seems likely. However, the timing of such a move is nearly impossible to predict, and there are many investors who have kept their bond money in ultra-low yielding cash-like instruments for more than half a decade, waiting for higher interest rates to materialize.

At the end of 2008, the 10-year US Treasury bond was yielding 2.1%, having come down from as high as 5.4% just 18 months earlier. It was right around this time that I recall hearing the first rumblings of investors preparing for higher interest rates and poor bond returns. So how have bond investors done since that time?

The Barclays US Aggregate Bond Index is often used as a broad proxy for the US investment grade bond market. From December 31, 2008 until July 31, 2014, the Barclays US Aggregate Bond Index has provided investors with an annualized return of 4.64%, or slightly less than 29% in cumulative total return. In dollar terms, an initial $100,000 investment in late 2008, at already historically low interest rates would have grown to just under $129,000 at present. For bond investors who were in cash over this period, the opportunity cost of sitting out of the bond market has been material.

Just last year, we saw the 10-year US Treasury go from yielding 1.6% in April to 3.0% by year-end. Those who were convinced that rates had started their long-term ascension were fleeing the bond markets once again. Sure enough, staying invested would have been the more appropriate decision, as we are currently looking at a 2.4% yield on the 10-year US Treasury 8 months later. Interest rates went down and bond prices went up.

At Sigma, we attempt to take a balanced approach to the bond markets. The key is to avoid getting overconfident, because doing so will surely reveal how much smarter the market is than any of its individual participants. For most of our clients who have an allocation to bonds, we like to have a range of maturities in the portfolio. If rates stay low, the bonds with slightly longer maturities will perform relatively well. If rates rise, maturity proceeds from shorter bonds can be redeployed at higher prevailing interest rates.

I will concede that bonds are unlikely to continue producing consistent, high single digit returns like those experienced over the last 30 years. However, investors should carefully examine the role of investment grade bonds in their portfolio before eliminating their exposure altogether.

Christopher W. Frayne, CFA®,CFP®

Second Chances: Investing in Your Life

It was a little over a year ago, shortly after getting in bed for the night, when I felt this intense pain in my sternum. Was this what it felt like to have a heart attack? I nearly worked myself into a frenzied panic. I did not want to alarm my wife, Shari, as I had just gone through a medical procedure (more on that later) that may have caused the pain, so I began to reason with myself, and finally concluded that if it was indeed life-threatening, there was not much I could do. At 52 years old, my life was full of blessings. My faith in Jesus Christ would serve me well in the afterlife.

As it turned out, I did not have a heart attack – just a bruised sternum. Just a few days earlier, I had experienced sudden cardiac death (SCD), which required the cardiologist in the emergency room to perform intense chest compressions for about a minute. After revival, I was wheeled into surgery, where the team of doctors implanted a pacemaker; a device referred to as the "guardian angel", which uses electrical pulses to prompt the heart to beat at a normal rate.

My internist and cardiologist were at a loss to provide an explanation for what caused the SCD. I exercised, watched my diet, and took precautions. It was a mystery.

After much research, and albeit contested by my doctor, I concluded my daily regimen of a drug called a "proton pump inhibitor" (PPI), which works to prevent stomach acid, had caused the problem. At my request, my physician took me off of the PPI, and instead prescribed an alternative. In subsequent visits to the cardiologist, it was confirmed that my heart rhythm had returned to normal. My pacemaker was "turned down" to preserve battery life.

It took me a few months of reflection to fully comprehend how fortunate and blessed I was. However, I still made slight adjustments in my life.

I "schedule", if you will, and unconditionally enjoy the time that I am able to spend with my best friend, Shari. We work together, bicycle together, and workout daily with a trainer. We savor our glasses of red wine in the evenings.

I take time conversing with my three adult daughters: Amanda, Ashley and Megan. I want to know what is going on in their lives, and to be a part of them.

I go four-wheeling with my darling granddaughters, sometimes searching for "swamp monkeys". I steal extra kisses and hugs. Every now and then, I magically find coins in their ears! Their affection, and my role as "their Papa", is truly a joy.

I regularly drop-in to see my 90-year-old father. He misses my mom, who died eight years ago, after 50+ years of marriage. I do not rush our visits. We celebrate life with outdoor barbecues, and we dissect the preceding day's Detroit Tigers' game. He does not miss many games, and occasionally, albeit accidentally, he may catch a rerun as well (live baseball in January?). It is a shared passion, mine learned from him.

My co-workers are like my family, and I stop by their workspaces to hear stories of their activities, families, and goings-on. We have all been sensitized to the blessing, and sometimes fleeting nature, of good health.

Many of my friends are clients, and many clients have become close friends. They trust me - confide in me - and I do not take that confidence lightly. I cherish these relationships.

My to-do lists have changed: I try to live well, I try to love well, and most importantly…I don't sweat the small stuff.

Sometimes we get second chances and sometimes we don't. Fate is funny that way.

Robert M. Bilkie, Jr., CFA®

Congratulations Nancy!

We would like to take this opportunity to recognize and congratulate our colleague, Nancy Kunkel, Client Services Supervisor, who this month celebrates 35 years at Sigma Investment Counselors. In this day and age of frequent job changes, this is truly a remarkable achievement.

Nancy has had a "birds-eye view" of the revolutionary operational changes in the industry. Where she once typed out investment reports by hand each month on an IBM Selectric typewriter, she now uses a computer keyboard to tease out much more robust reports and charts. Many of these never touch paper – only computer screens in clients' password protected vaults on the Sigma website. She also witnessed the firms assets under management grow from about $15 million in 1979 to over $700 million at present.

Yet perhaps most importantly, she combines friendliness with efficiency, characteristics that clients and co-workers have come to appreciate. Finally, she has helped promote a family atmosphere at Sigma, which gives it a unique "feel."

Thank you Nancy, for all of your years of hard work in serving clients!

27777 Franklin Road • Suite 1100 • Southfield, MI 48034 • tel (248) 223-0122 • fax (248) 223-0144 • www.sigmainvestments.com